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Supreme Court, U.S.
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No. _____

In the
Supreme Court of the United States
October Term, 1990

STEPHEN ADAMS,

Petitioner,

v.

RESOLUTION TRUST CORPORATION, as receiver for MIDWEST FEDERAL SAVINGS AND LOAN ASSOCIATION,
HAROLD W. GREENWOOD, JR.; DONALD SNEDE; and JOHN DOES 1-10,

Respondents,

and

STEPHEN ADAMS,

Petitioner,

v.

FEDERAL DEPOSIT INSURANCE CORPORATION (FDIC) as manager of the FSLIC RESOLUTION FUND,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

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QUESTIONS PRESENTED

1. Whether, without Congressional mandate, it is proper as a matter of "fairness and equity" to favor federally insured depositors and other general creditors over defrauded subordinated debenture purchasers after a federally insured savings and loan association becomes insolvent?

2. Whether the rule of Oppenheimer v. Harriman Nat'l Bank & Trust Co., 301 U.S. 206 (1937) applies to a defrauded purchaser of a subordinated debenture from a federally insured savings and loan association so that, upon insolvency of the institution, the purchaser may rank equally with depositors and other general creditors of the institution?

3. Whether a defrauded purchaser of a subordinated debenture issued by a

federally insured savings and loan association may be estopped from setting off his investment against a loan to him from the institution, dispute the fact that two obligations arose in a single transaction, based on a conclusive presumption that the purchaser must have known his funds would be used for the thrift's regulatory capital?

TABLE OF CONTENTS

	Page
QUESTIONS PRESENTED	i
TABLE OF AUTHORITIES	v
OPINIONS BELOW	2
JURISDICTION	3
STATUTES INVOLVED	3
STATEMENT OF THE CASE	4
A. Adams Transactions With Midwest Federal	9
B. The Complaint	16
C. The District Court Decision	18
D. The Court of Appeals Decision	22
REASONS FOR GRANTING THE WRIT ..	26
I. THE PANEL DECISION CONFLICTS WITH THIS COURT'S OPPENHEIMER DECISION AND THE SECOND CIRCUIT'S WEIS DECISION	26
A. The Panel Decision Renders Oppenheimer a Nullity	26

B. The Real Rationale of the Court of Appeals was to Protect the Government at the Expense of a Private Party - a Rationale That Must be Reviewed by This Court 31

C. The Panel Decision Distorts In Re Weis and the Concept of Estoppel as to Subordinated Debt Investments 33

D. The Decision of the Court of Appeals Allows a Fraud Initiated While an Institution was Operated Under Federal Regulation to be Completed by the Federal Government Itself 38

II. THE PANEL DECISION DEPRIVES ALL DEFRAUDED SUBORDINATED DEBT INVESTORS IN FEDERALLY INSURED INSTITUTIONS OF ANY REALISTIC REMEDY AND MUST IMPAIR THE ABILITY OF SURVIVING THRIFTS TO RAISE CAPITAL 40

CONCLUSION 43

APPENDICES (Separate Volume) ...

TABLE OF AUTHORITIES

CASES

	Page
Adams v. RTC, 731 F. Supp. 352 (D. Minn. 1990)	2, 6, 18, 21
Adams v. Resolution Trust Corp., 927 F.2d 348 (8th Cir. 1991)	2, 13, 22, 23
Coit Independence v. FSLIC, 489 U.S. 561 (1989)	27
FDIC v. United States National Bank, 685 F.2d 270 (9th Cir. 1982)	35, 36
Federal Deposit Insurance Corp. v. Citizens Bank & Trust Co., 592 F.2d 364 (7th Cir. 1979)	15
Northwest Racquet, Swim & Health Clubs, Inc. v. Resolution Trust Corporation, 927 F.2d 355 (8th Cir. 1991)	22, 23, 24, 31
Oppenheimer v. Harriman Nat. Bank, 301 U.S. 206 (1937)	7, 19, 23, 26, 29
Scott v. Deweese, 181 U.S. 202 (1901)	21, 24

In Re Weis Securities,
425 F. Supp. 212 (S.D.N.Y.
1977) 33

In Re Weis Securities,
605 F.2d 590 (2d Cir. 1978) .. 32

STATUTES

12 U.S.C. §63 28

12 U.S.C. §1441 ..... 4, 17

12 U.S.C. §1728(b) 31

12 U.S.C. §1729 ..... 3, 16

28 U.S.C. §1254(1) 3

28 U.S.C. §2101(c) 3

REGULATIONS

12 C.F.R. §563.8-1 ..... 4, 10

12 C.F.R. §563.13(b) 4, 39

12 C.F.R. §567.2(a) 40

IN THE
SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1990

Stephen Adams,

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v.

Resolution Trust Corporation as
Receiver for Midwest Federal
Savings and Loan Association;
Harold W. Greenwood, Jr.;
Donald Snede; and John Does 1-10,

Respondents,

and

Stephen Adams,

Petitioner,

v.

Federal Deposit Insurance
Corporation (FDIC) as manager
of the FSLIC Resolution Fund,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

Petitioner Stephen Adams [hereinafter "Adams"] respectfully requests that this Court issue a Writ of Certiorari to review the judgment and opinion of the United States Court of Appeals for the Eighth Circuit entered on February 28, 1991, in 927 F.2d. 348 (8th Cir. 1991).

OPINIONS BELOW

The opinion of the Court of Appeals for the Eighth Circuit is reported at 927 F.2d. 348 and is reprinted as Appendix A hereto at 1a. The court's judgment was also entered on February 28, 1991; it is printed in Appendix B hereto at 29a.

The February 9, 1990 decision of the district court, as amended March 2, 1990, is reprinted at 731 F.Supp. 352 (D. Minn. 1990) and ruling of the United States District Court for the District of

Minnesota (Rosenbaum, J.) is printed in Appendix D hereto at 70a-100a. The relevant excerpts of the transcript of proceedings are printed as Appendix G hereto at 108a.

JURISDICTION

The United States Court of Appeals for the Eighth Circuit entered its decision on February 28, 1991. Petitioner has not sought rehearing and this petition is filed within the time prescribed by 28 U.S.C. §2101(c). Petitioner seeks to invoke the jurisdiction of this Court under 28 U.S.C. §1254(1).

STATUTES INVOLVED

The complaint underlying this action was brought against Midwest Federal Savings & Loan Association of Minneapolis under the Federal Savings and Loan Insurance Corporation Act. 12

U.S.C. §1729, et seq. The Financial Institutions Reform, Recovery and Enforcement Act of 1989, 12 U.S.C. §§ 1441 et seq. is also involved in this action. The pertinent sections of each Act are is reprinted in Appendix F hereto at 101a-105a. Petitioner has also reproduced in Appendix F, relevant regulations promulgated under these Acts, 12 C.F.R. §§ 563.8-1, 563.13, 567.2, at 106a-107a.

STATEMENT OF THE CASE

This action was brought by an investor who was fraudulently induced to purchase a subordinated debt security issued by a federally insured and chartered savings institution. Unbeknownst to the investor, the thrift used the investment to increase its regulatory capital. When the investor learned the institution's financial

statements were fraudulent, he brought this action. Before the institution was closed but after the Federal Home Loan Bank Board ("Bank Board") had placed it in conservatorship, the investor then sought to set-off the subordinated debt investment against a loan he had outstanding from the institution. The Bank Board refused the setoff on the ground that the investment and the loan were not "mutual obligations". The investor then brought this action and the institution then went into receivership.

The United States District Court for the District of Minnesota granted a motion for summary judgment dismissing the investor's claims against the receiver. The district court concluded that, although the investor had been defrauded, he was estopped from rescinding the investment because the

institution had used the funds as regulatory capital. As the district court tersely put it: "[the investor] purchased subordinated debt - and that is precisely what he received." 731 F.Supp. at 357; Appendix D at 90a.

A panel of the Eighth Circuit Court of Appeals affirmed. The circuit court found that investments used as regulatory capital are fully encumbered by regulatory obligations and thus, in the event of insolvency, they remain subordinate to claims of depositors and general creditors, despite the institution's fraud upon the investor and the contractual rule that one cannot be bound by a term in a fraudulently induced agreement.

This case is an opportunity for the Court to examine the litigation posture of Resolution Trust Corporation

("RTC"), the institution's receiver, and the damage to principles of justice that courts do when they accept the RTC's insistence that unless the corporation is exempt from the rules that apply to everyone else, the savings and loan crisis may never be resolved. The remedy that was turned on its head in the lower court by this argument is estoppel. By applying the always suspect notion of a conclusive presumption and by legislating a preference for depositors and other creditors over defrauded investors, the panel reached a decision directly at odds with Oppenheimer v. Harriman Nat. Bank, 301 U.S. 206 (1937) and, in effect, authorized the successful completion of a fraud in process.

The Eighth Circuit panel appears to have been under the impression that its ruling would aid the RTC, and

inferentially the taxpayers, by excluding a large group of unsecured creditor claims against insolvent savings and loans. While that may be true in the short-term -- and will surely cause grievously unfair losses to investors far less well situated than petitioner here -- in the long-term it is the death knell for future capital investment in the thrifts that survive the crisis. If the panel decision stands and is followed, it means that no well-advised investor will put new capital into a thrift because, if the financial statements of the association are fraudulent or incorrect, the investor will have no remedy for that wrong when the association becomes insolvent. This short-sighted rule pertains nowhere in commercial law, except as to federally insured thrifts under the panel decision, and is

precisely the unwise policy this Court rejected in Oppenheimer. The Court ought to grant plenary review here and determine whether the Oppenheimer rule, which was born in the Great Depression, should continue into the 90's.

A. Adams Transactions With Midwest Federal

Until 1989, Midwest Federal Savings & Loan Association of Minneapolis ("Midwest Federal") was the second largest federally chartered thrift in the State of Minnesota, having first opened its doors in 1891. Midwest Federal was a mutual savings association, i.e., it had no shareholders. One of the few ways to introduce capital into such an institution, other than through earnings, is by subordinated debentures. A subordinated debenture investor lends funds to the institution, typically for more than five years at an agreed upon

rate of interest and the investment may, but need not, be used as regulatory capital.

A subordinated debt investment is not unlike an equity investment in that the investor subordinates his claim to the claims of all unsecured creditors of the borrower, i.e., all depositors, trade creditors and others. Thus, an investor considering subordinated debt must look to the retained earnings and other equity base to determine whether the investment is prudent. That information is typically supplied to the investor in the form of audited financial statements and unaudited interim financial statements that demonstrate the institution's capital base, the cushion available to protect the investment. Federal law requires that subordinated debt issues of federally chartered thrifts be approved

by the Bank Board. 12 C.F.R. § 563.8-1 (1988); Appendix F at 106a.

In early 1988, Adams was a customer of Midwest Federal, having loans outstanding of over $4 million. Midwest Federal solicited Adams to consolidate several additional loans at Midwest Federal and to borrow as much as $8 million on a new note. At the same time, Midwest Federal asked Adams to invest $2.5 million in subordinated debt to be issued by the thrift. Prior to the investment, Adams received and reviewed audited and unaudited financial statements from Midwest Federal. These financial statements show that Midwest Federal had regulatory capital of over $142 million.

On March 31, 1988, Adams invested $2.5 million and received a subordinated debt instrument issued by Midwest

Federal. The funds for the investment were obtained by Adams through a short-term loan from Midwest Federal itself. (In other words, Adams signed a promissory note for $2.5 million and delivered the note to the savings association in return for a $2.5 million subordinated debt instrument, which we now know was worthless at the time it was issued.)

Several months later, Adams borrowed $7.845 million from Midwest Federal. This loan consolidated Adams' other loans from Midwest Federal and some additional debts, including the $2.5 million loan whose proceeds had been used to purchase the subordinated debt. All of Adams borrowings from Midwest Federal were fully collateralized with, among other things, the controlling interest in a 17-bank holding company of which Adams

was the majority owner.

Unbeknownst to Adams, Midwest Federal used the proceeds of the subordinated debt investment to add to its regulatory capital. 927 F.2d at 348; Appendix A at 1a-28a. There is no contention that Adams knew, or could have known in the reasonable exercise of care, that his investment was necessary for Midwest Federal to meet minimum regulatory capital requirements, i.e., to keep the doors open. In fact, Midwest Federal was then in precarious financial condition.

For a period of time, Adams received the quarterly interest payments due under the subordinated debt agreement. In late 1988, however, Midwest Federal commenced a massive fraud action against one of its former affiliates and the financial strength of

Midwest Federal was publicly called into question. Adams then became suspicious that the financial information he had relied upon in purchasing the subordinated debt was bogus. The institution, however, remained open and publicly insisted it was healthy.

On February 13, 1989, ten months after Adams' subordinated debt investment, the Bank Board determined that Midwest Federal was insolvent and commenced a conservatorship to operate the institution as a going concern. Adams commenced this action on March 21, 1989 against the institution and certain former officers for securities fraud and related wrongs.

On May 4, 1989, the Bank Board determined that Midwest Federal's assets were less than its obligations and the institution was placed in receivership.

As is common in such circumstances, the Bank Board then created a new savings and loan association, Midwest Savings Association ("Midwest Savings") and transferred substantially all of the assets, and all but selected liabilities of the old institution, to the new one. This transaction is known as a "purchase and assumption." Federal Deposit Insurance Corp. v. Citizens Bank & Trust Co., 592 F.2d 364, 366 (7th Cir. 1979) (discussion of purchase and assumption agreements).

Adams was advised that Midwest Federal's liability to owners of subordinated debt securities was excluded from the transfer to Midwest Savings and that no assets of Midwest Federal remain for distribution to holders of subordinated debt. In effect, Adams was told that the Bank Board had left him

holding a claim against an empty shell. The $7.845 million promissory note from Adams to the institution, however, was transferred to Midwest Savings and continues to be an asset of the new institution and a potential claim against Adams.

B. The Complaint

On March 21, 1989, Adams brought this action against Midwest Federal and several of its former officers[1] alleging securities fraud and related wrongs and claiming violation of the Federal Savings

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[1]One of the many ironies of this case is the fact that, while the RTC insists Adams has no effective remedy for having been defrauded, the Department of Justice has indicted several former officers of Midwest Federal for mail fraud for defrauding what are known as the "Series IV" subordinated debenture investors - including Adams. One of the officers has pleaded guilty to securities fraud of the Series IV investors and the others are now being tried in St. Paul, Minnesota. United States v. Olson, et al., U.S. District Court, D. Minn., 3-90-Cr.34.

and Loan Insurance Corporation Act, 12 U.S.C. § 1729, for failure to ratably distribute Midwest Federal's assets, i.e., for excluding his setoff claim from the purchase and assumption. In short, the complaint alleged that the regulatory capital claimed in the financial statements that induced the subordinated debt investment was not present and, in fact, the institution was insolvent at the time Adams made the investment. In lieu of an answer, RTC, which then acted as receiver for Midwest Federal and conservator of Midwest Savings, moved to

dismiss.[2]

C. The District Court Decision

On February 9, 1990, U.S. District Judge James M. Rosenbaum dismissed the action against Midwest Federal and its receiver holding that "[w]hen a subordinated loan is used to enable a financial institution to comply with capital regulations, the subordinated lender properly is estopped from rescinding [his] agreement." 731 F.Supp. 352, 356 (D. Minn. 1990); Appendix D at 88a. Following Northwest Racquet, Swim & Health Clubs, Inc. v. FSLIC, 731

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[2] The Financial Institutions Reform, Recovery, and Enforcement Act ("FIRREA") was enacted on August 9, 1989, to restructure the federal savings and loan regulatory system. 12 U.S.C. §§ 1441-1446. FIRREA created the RTC, 12 U.S.C. § 1441a(b), which assumed most of the receivership, conservatorship, and liquidation functions of the Federal Savings and Loan Insurance Corporation ("FSLIC"), 12 U.S.C. § 1441a(b)(3), (6), and (10). The Act also abolished the FSLIC. 12 U.S.C. § 1725.

F.Supp. 352 (D. Minn. 1989), another case brought by a defrauded Series IV subordinated debt investor against Midwest Federal's receiver, Judge Rosenbaum found it more important that depositors and other creditors of the institution could rely on the stated capital resources of the thrift than that a remedy exist for a defrauded purchaser of the thrift's securities, even if the purchaser was unaware that his investment was used for regulatory capital.

The district court decision analyzed two cases, Oppenheimer v. Harriman National Bank & Trust Co., 301 U.S. 206 (1937) and In Re Weis Securities, 605 F.2d 590 (2d Cir. 1978), cert. denied, 439 U.S. 1128 (1979). In Oppenheimer, this Court held that purchasers of bank stock could rescind their purchases, and rank with unsecured

creditors, if their investments had been fraudulently induced; in Weis, the Second Circuit held that investors in a securities brokerage house, who knew at the time they invested that their funds were being used to meet minimal regulatory capital so a precarious enterprise could continue in business, could not, after discovery of fraud in the inducement, be placed in parity with other unsecured creditors.

Judge Rosenbaum reasoned that Oppenheimer was inapt because the case arose when federal law required shareholders in a federally chartered bank to pay in additional capital in the event of insolvency; the Oppenheimer shareholders were allowed general creditor status because they, in effect, purchased this status by paying in additional capital to pay unsecured

creditors. As to Weis, Judge Rosenbaum stated that the use to which the proceeds of the investment was put is dispositive and not the actual knowledge of that use by the investor; thus if the institution used the funds for regulatory capital, then even if defrauded, the investor could not renounce his subordinated status. 731 F.Supp. at 356, 357; Appendix D at 68a-90a. Judge Rosenbaum bolstered this conclusion by citing Scott v. Deweese, 181 U.S. 202, 212 (1901) and holding that Adams must be conclusively presumed to know that his subordinated debt investment increased Midwest Federal's regulatory capital and

facilitated the conduct of its business.[3]

D. The Court of Appeals Decision

The same panel of the Eighth Circuit Court of Appeals heard Adams' appeal and the appeal in Northwest Racquet the same day and decided them both on February 28, 1991. The Adams decision, 927 F.2d 348 (8th Cir. 1991) relied upon reasoning set forth in Northwest Racquet, Swim & Health Clubs, Inc. v. Resolution Trust Corporation, 927 F.2d 355 (8th Cir. 1991) ("Northwest

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[3]In a second action, Adams v. Federal Deposit Insurance Corporation, petitioner sought to invalidate the purchase and assumption agreement he had with Midwest Savings and thus be entitled to ratable distribution of assets to general creditors. The district court dismissed the second proceeding because, in the first action against, Adams v. Resolution Trust Corp., et al., it determined that because Adams could not rescind his subordinated debenture purchase he retained his subordinated status to general creditors. As a result, the Court concluded that Adams had no right to ratable distribution. Appendix E at 98a-100a.

Racquet"), cert. applied for May 28, 1991.[4] After reviewing Weis, and purporting to distinguish Oppenheimer in a footnote, 927 F.2d at 361 and n. 17, Appendix C at 56a, the Eighth Circuit concluded that the investors were estopped from rescinding their subordination agreements after the date

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[4]The Northwest Racquet opinion is printed in Appendix C hereto at 31a-69a.

of insolvency.[5] 927 F.2d at 360; Appendix C at 52a-53a.

The Eighth Circuit acknowledged that Weis involved investors who knew their investments were being used to keep open the doors of a precarious enterprise, but said it made no difference because Midwest Federal's subordinated debt investors knew their investments could have been used for

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[5]The Court of Appeals makes much of the fact in both cases that on February 13, 1989, the Bank Board declared Midwest Federal insolvent and the subordinated debt investors did not sue until shortly thereafter, Adams, 927 F.2d 348, 353, n. 13, Appendix A at 21a, Northwest Racquet, 927 F.2d at 358, 363, and n. 21, Appendix C at 68a. These details ignore the fact that when Midwest Federal was placed in receivership on February 13, 1989, the Bank Board determined to operate it through a conservatorship as a going concern and it was not until May 4, 1989, that the condition of the institution was deemed too weak to be operated as a going concern and a receiver was appointed. As in Oppenheimer, however, Adams brought this action after the conservatorship commenced but before the receivership began. 301 U.S. 207-208.

regulatory capital and thus "the investors must be conclusively presumed to know that they have increased the institution's capital and facilitated the conduct of its business . . . ." 927 F.2d at 362; Appendix C at 61a. See Scott v. Deweese, 181 U.S. at 212.

The Eighth Circuit essentially saw the dispute here "as one between the investor and general creditors, including innocent depositors." 927 F.2d at 361; Appendix C at 57a. While agreeing that perhaps all such parties "are victims of the institution's fraud," the court concluded that "fairness and equity dictate that investors, having undertaken the greater risk, give way to the depositors and general creditors" when the institution becomes insolvent. Id. Thus, Adams is estopped from claiming he is a general creditor as a victim of a

fraud, and must be subordinated as set forth in the agreement he was defrauded into executing.

REASONS FOR GRANTING THE WRIT

I. THE PANEL DECISION CONFLICTS WITH THIS COURT'S OPPENHEIMER DECISION AND THE SECOND CIRCUIT'S WEIS DECISION.

A. The Panel Decision Renders Oppenheimer a Nullity.

Oppenheimer is a straightforward case. In 1930, Henry Oppenheimer invested $15,120 in Harriman National Bank and Trust Co. The investment was induced "by false and fraudulent representations" by Harriman officers, 301 U.S. 209, and thus the bank "immediately became bound to make restitution," 301 U.S. 213-14; of course at the outset Oppenheimer was unaware he had been cheated and hence that the sale was "subject to rescission by [Oppenheimer] at any time before the declaration of insolvency". Id. at 214.

Shortly after a conservator was appointed for the bank in March 1933, Oppenheimer demanded and later sued for rescission. The bank regulators argued several inconsistent defenses, but did convince the Court of Appeals to limit Oppenheimer to relief only after all unsecured creditors, including depositors, were paid. This Court reversed and held that Oppenheimer was an unsecured creditor of the bank, just like the depositors. Id. at 214.

This Court viewed the case as one of statutory interpretation. After examining several bank regulatory statutes, the Court said the statutes "cannot reasonably be construed to forbid rescission of fraudulent sales by national banks of their own stock". Id. at 211. Unless Congress enacted "language unquestionably disclosing that

purpose," no such intent may be inferred. Id. [Compare Coit Independence v. FSLIC, 489 U.S. 561 (1989)].

Yet in the instant case, the panel below concluded that rescission was barred without citing any statutory language that "unquestionably" or otherwise disclosed such a purpose. The rationale used by the panel was "fairness and equity", not what Congress prescribed.

The Eighth Circuit viewed Oppenheimer as a case to distinguish, not a ruling to follow. The Eighth Circuit turned to a fact distinction between the two cases and concluded it made a crucial legal difference. The fact distinction was that at the time of Oppenheimer investors in national banks were exposed, in the event of insolvency, to an assessment by the comptroller of the

Currency for up to the par value of their stock, i.e., if the bank went under they might have to double their investments. See 12 U.S.C. § 63, repealed in 1959; Appendix F at 101a. The Eighth Circuit said this distinction -- which it apparently thought, erroneously, meant that all unsecured creditors of the bank would be paid in full -- made all the difference in the world. Adams had not been assessed anything -- because there was no comparable law in the 1980's to authorize such assessment -- and the lower court concluded that he could not claim the benefit of Oppenheimer.

This decision demonstrably misreads Oppenheimer and is a paradigm of a distinction without a difference. First, Oppenheimer addressed subordinated debt investments, albeit in dicta. The Court, in trying to point out how the

bank regulatory statutes do not inferentially destroy the rescission remedy, gave some examples of bank liability that squarely apply here:

> "The bank's liability does not differ from what it would be if, instead of shares of its own stock, it had fraudulently sold to plaintiff bonds or other investment securities."

301 U.S. at 211.

Subordinated debt is either a "bond or other investment security."

More fundamentally, however, the Eighth Circuit ignored the essence of Oppenheimer: unless Congress "unquestionably" demonstrates an intention not to allow investors to rescind fraudulently induced investments, they have that right. One searches the Eighth Circuit decisions in Adams and Northwest Racquet for any such congressional statement or intent.

B. **The Real Rationale of the Court of Appeals was to Protect the Government at the Expense of a Private Party - a Rationale That Must be Reviewed by This Court.**

The fact that a Court of Appeals misreads a decision from this Court may not justify a writ of certiorari; the fact that a Court of Appeals draws an apparently unfair distinction between similarly situated parties without congressional mandate is more serious, but also may not justify plenary review. The reason this Court ought to examine this case, however, is because the rationale used by the Court of Appeals is a thinly disguised effort to favor the government over a private party where Congress has not mandated such a result. It is a significant step on the road to a ruinous commercial situation: deal with a federally insured institution at your peril.

The motivation of the Court of Appeals for estopping Adams and the Northwest Racquet claimant was that other creditors of Midwest Federal, especially depositors, have a higher right to recovery than subordinated debt investors after the institution becomes insolvent. This conclusion is supported by the need for depositors and general creditors to look to the regulatory capital of an institution, especially "during an economic downturn, and particularly in the event of insolvency." 927 F.2d at 361. Appendix C at 55a-56a. Thus, on their face, the decisions below claim to protect depositors.

But no depositor will lose a nickel on the failure of Midwest Federal. Federal insurance protects the depositors; they are promptly paid from the insurance fund. 12 U.S.C. § 1728(b).

Indeed, for the same reason, it is most unlikely that any depositor -- unlike a subordinated debt investor -- paid much attention to the financial statements of Midwest Federal or its competitors. The real rationale here was to protect the federal treasury at the expense of Adams and other investors.

Whether the federal treasury should be protected in such circumstances, where Congress has not mandated that result, is a question of serious national importance and should be addressed by this Court.

C. The Panel Decision Distorts In Re Weis and the Concept of Estoppel as to Subordinated Debt Investments.

Vague "regulatory interests" were used by the Eighth Circuit panel to justify the refusal to give Adams a day in court. The Eighth Circuit relied upon In Re Weis Securities, 605 F.2d 590 (2d

Cir. 1978) as authority to estop Adams from rescinding the subordinated debt purchase. Weis involved subordinated loans to a securities broker but, unlike the present circumstances, the Weis investors knew that the broker-dealer was in precarious financial circumstances and their loans were being used to satisfy the regulators so the doors could be kept open, i.e., so others could deal with the broker unaware of his precarious condition.[6]

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[6]See In Re Weis Securities, 425 F.Supp. 212, 216 (S.D.N.Y. 1977)

> ("Weis and subordinated lenders knew that the subordination was to meet the statutory requirements for a broker-dealer to continue in business and knew it was for the protection of the general class of Weis customers who, as long as Weis continued to operate, would continue to incur general obligations of Weis.")

The present case, as the Eighth Circuit admitted, is directly to the contrary: Adams did not know that his $2.5 million contribution was somehow necessary to keep the doors open at Midwest Federal. Another rich irony present in this case is that the way that Midwest Federal defrauded Adams is by claiming that it had $142 million for regulatory capital to serve as a cushion for his investment when, in fact, this capital was illusory and the regulators were breathing down the necks of Midwest Federal's senior managers to add new capital at the end of each quarter. That is why the Adams investment was made at the end of a calendar quarter.

Thus, Weis is a garden variety estoppel case. It would not have been fair for the Weis subordinated debt lenders to stand in the same class as

general creditors when the subordinated debt lenders knew they were investing in a precarious institution and their loans allowed it to remain open, while other creditors did not have that knowledge. The Weis investors were estopped by their own knowledge, a circumstance demonstrably not present here.

This Court should address the question of whether Weis should be read to apply traditional estoppel principles of bar by the victim's own knowledge of certain circumstances, or the novel estoppel view adopted by the Eighth Circuit, of bar by the wrongdoer's

knowledge.[7]

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[7]The Ninth Circuit, in FDIC v. United States National Bank, 685 F.2d 270 (9th Cir. 1982) conflicts with the panel decision here and supports the conclusion that Adams submits. In United States National Bank, the Federal Deposit Insurance Corporation ("FDIC") was on both sides of the case; it proceeded on behalf of a failed bank which had been a subordinated investor in another bank that later failed. The Ninth Circuit allowed rescission and distinguished Weis:

> In Weis, subordinated loans were made to the failed broker-dealer for the specific purpose of insuring the broker-dealer's compliance with the net capital rules. The lenders were aware that the amounts of their loans would not be added to the firm's aggregate indebtedness for purposes of determining compliance.

685 F.2d at 274.

The decision of the Eighth Circuit in the instant case and the decision of the Ninth Circuit in United States National Bank cannot co-exist.

D. **The Decision of the Court of Appeals Allows a Fraud Initiated While an Institution was Operated Under Federal Regulation to be Completed by the Federal Government Itself.**

This case also presents a unique procedural position: the completion of the fraud and the taking of funds from the victim will occur, under the decision of the Court of Appeals, after the RTC has assumed control of the wrongdoing institution and after the fraud has been discovered. The circumstances under which it is appropriate for the RTC to participate in the completion of a banking fraud are worthy of consideration by this Court.

Removed of its procedural garb, the transaction between Adams and Midwest Federal is simple: Adams executed a $2.5 million promissory note and delivered it to the association in return for a $2.5 million subordinated debt instrument. No

money changed hands and the association simply made an accounting change in its ledgers moving funds from another source into an asset classification (the loan to Adams) and the proceeds of that loan into its own equity. Since the loan was secured shortly after it was made, moreover, the institution was never at risk.

Now that fraud has been discovered, the RTC nevertheless insists that it must collect upon the $2.5 million obligation from Adams to Midwest Federal that had its genesis in fraud. In essence, the RTC is completing the fraud. This is a fundamentally different situation than if Adams had paid cash in March, 1988, for the subordinated debt instrument and later the institution had been declared insolvent.

A key issue presented here is the circumstances under which the RTC may complete a bargain that arose due to the fraudulent conduct of bank officers. The litigating posture of the RTC, which argues it has a right to complete such fraudulent transactions, is one that should be approved after only the most careful thought. At risk is the full faith and credit of the United States because people will not long bargain with a party who is free to operate under rules different and less fair than the ones they must abide.

II. THE PANEL DECISION DEPRIVES ALL DEFRAUDED SUBORDINATED DEBT INVESTORS IN FEDERALLY INSURED INSTITUTIONS OF ANY REALISTIC REMEDY AND MUST IMPAIR THE ABILITY OF SURVIVING THRIFTS TO RAISE CAPITAL.

The importance of the question of where defrauded subordinated debt investors stand versus other unsecured

creditors of federally insured institutions is magnified since recently Congress sharply increased the capital requirements for thrifts and subordinated debt is the principal way that any thrifts that survive the current crisis will satisfy the increased requirements. Compare old 12 C.F.R. § 563.13(b), Appendix F at 106a, (savings institutions required to maintain regulatory capital of at least 3% of total liabilities) with new 12 C.F.R. § 567.2(a). Appendix F at 107a. (Savings associations must maintain regulatory capital of at least 6% of category one risk-weighted assets plus an additional 2% of category two risk-weighted assets).

It is easy to predict how investors, especially sophisticated investors, will respond to a rule that persons other than depositors or trade

creditors of a thrift or bank must, even if they were defrauded, stand behind all such other creditors in the event of insolvency. Increased cost of funds for thrift capital is an obvious result, if such funds will be available at all.

The regulatory and investment issues presented by this case are not restricted to thrift institutions. Commercial banks also use subordinated debentures as a method to raise capital. As the failure of federally insured commercial banks continue to rise, the problems illustrated and associated with thrift institutions here, will affect the investments of commercial banking institutions as well. Normally this Court could stand aside and allow the law to develop in the circuit courts. In the present circumstances, that course is not realistic. The capital markets are

making decisions everyday as to whether investors should invest in the thrift crisis survivors. This Court should look now to the question of whether defrauded subordinated debt investors can rely upon Oppenheimer when the institution becomes insolvent, or have to suffer their losses without any remedy.

CONCLUSION

For reasons set forth above, the writ should be granted.

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Respectfully
submitted,

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